

Supplemental Instructional Services offered through a Dependent Care Flexible Spending Account

Present Law:

Under present law, an employer may establish a flexible spending account (FSA) either as a stand-alone plan or as part of broader cafeteria benefit plan. An FSA allows an employee to set aside a portion of his or her earnings to pay for qualified medical and dependent care expenses. Money deducted from an employee's paycheck into an FSA is not subject to income or payroll taxes, thus saving both the employee and employer taxes. Employers may offer employees one or both types of FSAs, but the money contributed to each must be kept separately.

The most common type of FSA is used to pay for medical expenses not paid for by insurance; this usually means deductibles, copayments, and coinsurance for the employee's health plan, but may also include expenses not covered by the health plan, such as dental and vision expenses and over-the-counter drugs. A medical FSA cannot pay for health insurance premiums, cosmetic items, cosmetic surgery, or items that improve "general health". There is no statutory cap on contributions, but an employer may establish dollar cap as part of its plan document.

FSAs may also be established to pay for certain expenses to care for dependents that live within the home while the taxpayer is at work. While this most commonly means child care, it can also be used for adult day care for senior citizen dependents, such as parents, who live with the taxpayer. It cannot be used for summer camps (other than "day camps") or for long term care for parents that live elsewhere (such as in a nursing home). Dependent care FSAs are subject to \$5,000 cap on contributions. If married, both spouses must earn income in order for the dependent care FSA to work. The only exception is if the non-earning spouse is disabled or a student. If one spouse earns less than \$5,000 then the benefit is limited to whatever that spouse earned.

Reasons for Change:

Many middle class families find themselves in a chronic financial crisis with an ever growing portion of a family's income going towards mortgages and health care. At the same time, the value of a college education on income earning has grown dramatically; a worker holding a degree from a 4-year college now earns 96% more than a person with a high school diploma. Many middle class children are performing below grade level in our public schools. For example, 32 percent of eight graders score below basic in mathematics and 37 percent score below basic in reading. Federal law now provides lower income families with resources for professional tutoring services, while upper income families take full advantage of supplemental education services. This proposal is intended to help middle income children obtain professional supplemental instructional services by allowing an employee to pay for such services on a before-tax basis.

Explanation of Proposal:

Under the proposal, an employer may cover supplemental instructional expenses as part of dependent care FSA. The term “supplemental instructional services” is defined as the payment of, or provision of, services to a dependent between the age of 5 and 19 who has not obtained a high school diploma or been awarded a General Education Degree (GED) for instructional or other academic enrichment services that are in addition to instruction provided during the school day; specifically designed to increase the academic achievement of such dependent; in the core academic studies of English, reading or language arts, mathematics, science, foreign languages, civics and government, and social studies; and provided by a state certified instructor or accredited organization.

Additionally, only nonhighly compensated employees (\$100,000 or less for 2007) would be able to exclude amounts paid for supplemental instructional services from their taxable income. Additionally, supplemental instructional expenses would be subject to a combined \$5,000 cap with dependent care expenses. To access the Dependent Care/Supplemental Education FSA, an employer would have to amend its existing Dependent Care FSA. Additionally, for Supplemental Education expenses, it would not be necessary for both spouses to be working.